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Report to the Chairman, Legislation and National Security Subcommittee, Committee on Government Operations, House of Representatives

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ENVIRONMENTAL CLEANUP

Defense Indemnification for Contractor Operations

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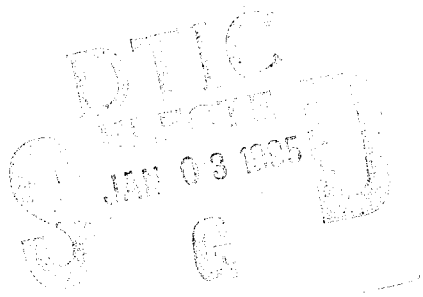

The Honorable John Conyers, Jr.
Chairman, Legislation and
National Security Subcommittee
Committee on Government Operations
House of Representatives

Dear Mr. Chairman:

As requested, we are examining selected actions taken by the Department of Defense (DOD) under Public Law 85-804.[1] Specifically, this interim report provides information on (1) how the military services used Public Law 85-804 to indemnify contractors for environmental cleanup in selected cases and (2) how DOD described the resulting actions in required reports to Congress.

Background

Public Law 85-804, as implemented, authorizes DOD and other federal agencies to indemnify contractors against losses from unusually hazardous or nuclear risks. The law requires that if any actions are taken under the law, they be reported to Congress annually. Reported actions can include specific contractors' claims for costs already incurred or the inclusion of indemnification clauses in contracts to protect DOD contractors from future risks.

The Comprehensive Environmental Response, Compensation, and Liability Act (CERCLA), as amended, commonly known as Superfund (42 U.S.C. 9601-75), imposes liability for cleanup on a variety of potentially responsible parties, including owners, facility operators, and generators of hazardous substances. Under CERCLA, DOD is included among parties responsible for environmental cleanup of its facilities. If DOD pays cleanup costs related to a contractor's activities, the contractor remains a potentially responsible party under CERCLA, and DOD could seek reimbursement or possible contribution from the contractor or its insurer.

[1]Under P.L. 85-804, the National Defense Contracts Act of 1958, as implemented by Executive Order 10789 and the Federal Acquisition Regulation, three major types of actions may be taken: advance payments; contract adjustments; and any other actions under authority of the act, referred to as residual powers. A frequently reported action under residual powers is indemnification of contractors against losses from unusually hazardous or nuclear risks that are not otherwise insured.

In May 1993, we testified that DOD officials had stated that indemnification of contractors for environmental cleanup would seldom, if ever, occur.[2] However, we also noted that the Army has included indemnification clauses in contracts at facilities where environmental cleanup is necessary. We expressed concern about the substantial costs that could be involved and suggested that DOD expand guidance to the services to fully describe the types of situations that might warrant contractor indemnification for environmental cleanup.

In November 1993, a House Committee Report on contractor reimbursement issues cited DOD's position that it uses Public Law 85-804 to indemnify certain contractors against unusually hazardous or nuclear risks, not for environmental cleanup costs.[3] In July 1994, we reported that the Army was paying for environmental cleanup costs at its Army ammunition plants.[4] Army headquarters officials stated that the Army was paying because it owns the facilities and is one of the parties responsible for cleanup under CERCLA, although field officials said they believed Public Law 85-804 was the basis for payment.

Results in Brief

The Army granted relief under Public Law 85-804 to a contractor for $5 million for environmental restoration at a plant in Eau Claire, Wisconsin. Also, the Army included the Public Law 85-804 clause in contracts with operators at 20 of its ammunition plants in the early 1990s to indemnify against unusually hazardous risks (defined as including, in certain circumstances, environmental releases of hazardous substances). The presence of this clause in a contract does not mean that all of a contractor's environmental cleanup costs would be indemnified. Such a determination in certain cases could only be made based on the assessment of whether a contractor's claim is consistent with the definition of unusually hazardous risk contained in the clause. DOD expects cleanup at these plants to total $800 million. The Army has not determined the amount for which contractors could be liable, and the portion, if any, affected by these indemnification clauses is unknown. The Navy includes Public Law 85-804 nuclear indemnification clauses in its nuclear-related

[2]Environmental Cleanup: Unresolved Issues in Reimbursements to DOD Contractors (GAO/T-NSIAD-93-12, May 20, 1993).

[3]Reimbursement of Defense Contractors' Environmental Cleanup Costs: Comprehensive Oversight Needed to Protect Taxpayers, Fifth Report by the House Committee on Government Operations (Nov. 22, 1993).

[4]Environmental Cleanup: Inconsistent Sharing Arrangements May Increase Defense Costs (GAO/NSIAD-94-231, July 7, 1994).

contracts. According to the Navy, the clause contractually obligated the Navy to pay the three contractors' share of the costs for cleaning up low-level radioactive waste at Maxey Flats, Kentucky. The Navy has obligated $5.8 million for its own share of this cleanup and currently estimates the contractors' share will be another $2 million. Air Force officials stated they were generally not in favor of indemnifying contractors against environmental cleanup costs.

Our review of DOD's reports to Congress for 1962 through 1993 indicated that the reports generally do not provide sufficient detail to determine whether the contracts or actions listed are environment related. The Army reported its payment of $5 million for cleanup at Eau Claire, Wisconsin, providing a detailed justification.[5] Also, the Army reported the inclusion of indemnification clauses in contracts for 18 of the above 20 ammunition plants. The report did not specify whether the clauses encompassed environmental cleanup and cited potential cost as zero, explaining that the costs could not be determined. Navy officials stated that the contingent liability provisions in the Maxey Flats contracts were reported in the 1960s, but they have not yet identified the specific year reported. We found no reports showing projected or incurred costs on behalf of contractors involving Maxey Flats.

Environmental Indemnification Under Public Law 85-804

In at least two instances, the Army and Navy have used Public Law 85-804 to grant relief to contractors for environmental cleanups. In the cases examined, the Air Force has not.

Army Has Used Public Law 85-804 Authority to Indemnify Environmental Cleanup

The Army used Public Law 85-804 in 1988 to reimburse the National Defense Corporation for $5 million in environmental cleanup costs it had incurred at the Eau Claire, Wisconsin, facility. The relief was granted to ensure the corporation could continue to produce parts deemed essential to the national defense.[6] According to the Public Law 85-804 report, payment was to be funded from an Army procurement account.

[5]An Army official recently stated that the $5-million indemnification may not have been an action under the law and the Army was further researching this case.

[6]Public Law 85-804 authorizes extraordinary relief when the President or a designee "deems that such action would facilitate the national defense."

The Secretary of the Army issued memorandums of decision in 1990 and 1992 authorizing the inclusion of Public Law 85-804 clauses in contracts with ammunition plant operators, as well as other contractors, subcontractors, and third party contractors whose ultimate customer is the government.[7] The Army included the Public Law 85-804 clause in 20 contracts with ammunition plant operators. DOD expects cleanup at these plants to total $800 million.[8] The Army has not determined the amount for which contractors could be liable, and the portion of funding, if any, affected by these indemnification clauses is unknown.

The Secretary of the Army's memorandums define unusually hazardous risks in part as including ". . . the risk of release, including threatened release, whether on-site or off-site, sudden or nonsudden, of any substance or material . . . ." Also, documents supporting the decision show that "environmental releases of hazardous substances" are included in this definition. Headquarters officials acknowledged that the Army's definition of unusually hazardous risks could encompass environmental contamination.

As discussed in our July 1994 report, there is confusion among Army officials as to whether relief had actually been granted under indemnification provisions. Command and field officials told us that the Army is paying the cleanup bill at the ammunition plants because the operators could be indemnified for such costs under Public Law 85-804 anyway. Headquarters officials, however, said that the contract indemnification provisions are not invoked because the Army is paying the cleanup costs directly. Under CERCLA, the Army has assumed responsibility for environmental cleanup of its facilities. For that reason, plant operators have not incurred costs and therefore have had no reason to submit claims for environmental relief.

Navy Has Used Public Law 85-804 Authority to Indemnify Contractors for Low-Level Radioactive Waste

According to Navy officials, the Navy uses Public Law 85-804 to indemnify contractors only under limited circumstances. The Navy authorizes Public Law 85-804 clauses in contracts for procurement of nuclear-powered vessels, missiles, and components or subcomponents because these contracts involve nuclear or unusually hazardous risks for which the

[7]According to one official, the Army is currently drafting a memorandum to eliminate indemnification for third parties because the Army believes that private insurance coverage is available to such contractors.

[8]Defense Environmental Cleanup Program, Annual Report to Congress for Fiscal Year 1993 (Mar. 31, 1994).

contractor cannot obtain insurance. They believe the Navy has no need to indemnify its facility operators because their operational risks are not considered unusually hazardous.

The Navy also used Public Law 85-804 to indemnify three contractors—Newport News, Electric Boat/General Dynamics, and Ingalls/Litton Systems—for disposal of low-level, nuclear waste at a site at Maxey Flats, Kentucky. These three contractors were identified, along with the Navy, as potentially responsible parties under CERCLA. The Navy assumed all three contractors' shares of remediation costs, stating that it was contractually obligated to do so.

A Navy official stated that the Navy has not yet paid any money pursuant to an indemnification claim. The total cost to the Navy for the Maxey Flats cleanup will not be known until the Navy signs a consent decree with the Environmental Protection Agency. However, the Navy is responsible for 12.4 percent of the cleanup bill, of which 4.5 percent represents the three contractors' portion. A Navy attorney stated that this 4.5 percent is currently estimated to be $2 million. According to a Navy Facilities Command official, the Navy has obligated $5.8 million for its share of the cleanup at Maxey Flats since 1987, and the money has been funded through the Defense Environmental Restoration Account.

Air Force Has Not Used Public Law 85-804 Authority to Indemnify Environmental Cleanup

According to Air Force officials, activities under facilities-use contracts at contractor-operated facilities do not involve unusually hazardous risks and, therefore, do not need to be indemnified under Public Law 85-804.

We reported in July 1994 that a 1987 memorandum from the former Air Force Systems Command said that Plant No. 44's operator, Hughes Missile Systems Company, was indemnified from responsibility for past groundwater contamination. However, according to an Air Force official, further investigation showed that the operating contract between the Air Force and Hughes made no reference to Public Law 85-804 and the 1987 document ". . . in no way was, or was intended to be, an indemnification of liability for future remediation costs occasioned by contamination of the groundwater at the facility."

The Air Force recently negotiated a lease with Hughes that replaced the facilities-use contracts that have governed Hughes' operations at the

Tucson, Arizona, plant since 1951.[9] Under the lease, the government will continue funding remediation projects for contamination that occurred prior to the lease. However, according to Air Force officials, the decision to fund the remediation at Plant No. 44 has nothing to do with determining ultimate liability for cleanup costs. Air Force Systems Command officials stated that the Air Force intends to seek contributions from the contractors that operated its facilities.

The lease between the Air Force and Hughes does contain a Public Law 85-804 indemnification clause. Air Force officials stated that the clause is not intended to grant relief for environmental cleanup. We are continuing to review the above issues in our ongoing work.

Public Law 85-804 Reports

Pursuant to Public Law 85-804, each agency using the indemnification authority must report its actions in the annual report to Congress. If an action involves actual or potential costs in excess of $50,000, the report must include the contractor's name, actual or estimated potential costs, description of property or service involved, and circumstances justifying the action. In reviewing the Public Law 85-804 reports for 1962 through 1993, we found that 2,874 actions had been reported.[10] Two types of actions were reported: one type includes a description of the action and justification, and the other lists only the number of contracts with contingent liability provisions by contractor name. Only one action of the first type, in Eau Claire, Wisconsin, cited environmental restoration.

The annual reports generally do not provide specific information on indemnification that could include environmental and associated costs. Other than the $5-million action, we found no cases where any environmental cleanup costs had been specified in a report. The current reporting system does not provide a mechanism for linking the actions with descriptions and justifications to those previously reported as having contingent liability provisions.

The information in DOD's report is submitted by the services and other DOD agencies to the Office of the Secretary of Defense. The data is computed and reported annually to Congress in a document entitled "Extraordinary Contractual Actions to Facilitate the National Defense."

[9]Since the Air Force is trying to divest itself of its contractor-operated facilities and will not receive funding to maintain them in the future, the Air Force decided to lease the plant to Hughes.

[10]Actions may involve one or more services or DOD agencies.

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